World Growth and Weaker Dollar Expected To Boost Exports

The world economy was in a recession in 1998 because of the global financial crisis, but the U.S. economy continued to grow due to low interest rates, low oil prices, and solid productivity growth. However, the U.S. trade deficit increased sharply in 1998 and 1999, negatively affecting the goods-producing sector, particularly, agriculture and manufacturing. U.S. agricultural exports dropped partly due to a strong dollar and weak world growth as well as record large world supplies. Although nonmetro employment growth dipped in 1997-98, the nonmetro United States did not experience lasting damage from the global financial crisis. Based on most indicators, the world economy is clearly on the road to recovery with improvement in U.S. nonmetro employment and farm exports expected in 2000.

The world financial crisis began in the summer of 1997 with a sharp devaluation of the Thai currency. The crisis spread to other countries of East and South Asia, Russia, and Brazil. A huge outflow of investment funds from these and other developing countries resulted in a world recession in 1998. Investment funds flowed into the United States as a safe haven. As a result, the value of the dollar rose and long-term U.S. interest rates fell sharply (fig. 1). Further, weak world growth and failure of Organization of Petroleum Exporting Counties (OPEC) discipline resulted in low oil prices at the end of 1998—the lowest in real terms since 1947.

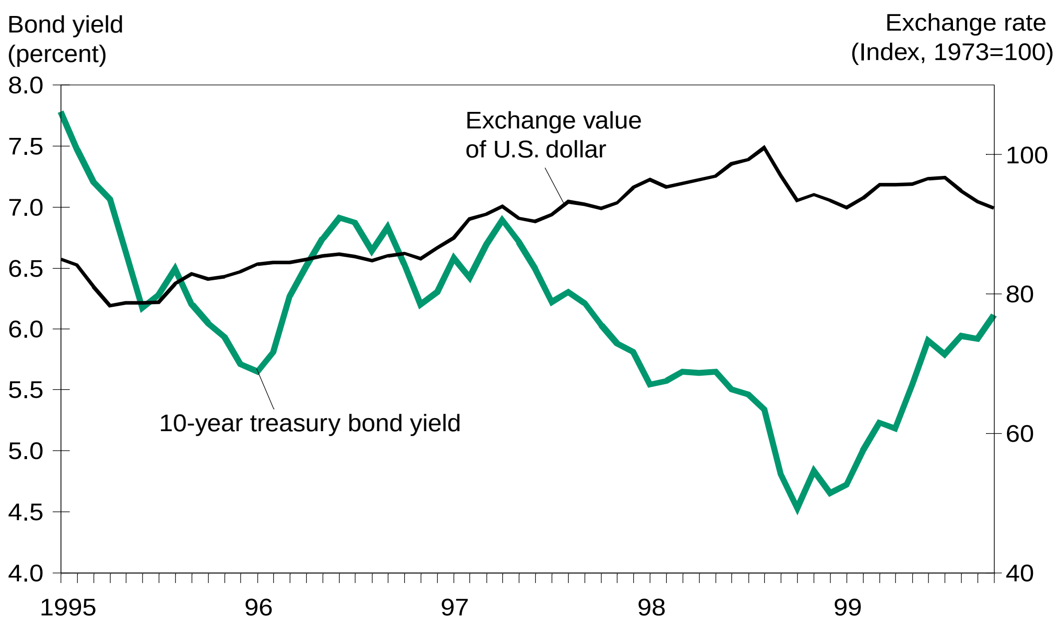
The quick turnaround in Asian and world growth was crucially dependent on a strong U.S. economy absorbing increasing trade deficits. Japan, a major trading partner of the affected Asian countries, and Europe were experiencing sluggish growth. If the United States had not been able to absorb the imports that were needed to boost the Asian economies, no other country could have.

Overall, the U.S. economy was the locomotive that pulled the world out of recession. The already fully employed U.S. economy continued to expand in 1998 and 1999 at about a 4-percent growth rate for gross domestic product (GDP), with inflation at about 2 percent. The strong dollar kept imported goods prices low while low oil prices provided a boost to the supply side of the economy and further constrained inflation. Real compensation rose with no rise in inflation due to low input price inflation, to oil price declines, and to solid U.S. productivity growth from expanded and more effective business computer usage along with a high rate of capital growth. Increasing compensation, low interest rates, and rising household wealth spurred rapid consumer spending growth. Low interest rates and

Figure 1

Treasury bond yields and value of the U.S. dollar, 1995-99

Long-term interest rates reversed their decline in 1999 as growth in the value of the dollar stalled



Note: Exchange rate is a trade-weighted index of the value of the dollar against major currencies, not adjusted for inflation. The index equaled 100 in March 1973.
Source: Federal Reserve Board.

strong equity prices allowed continued growth in business investment spending. As a result, growth continued unabated despite a sharply rising trade deficit.

Still, the major goods-producing sectors—agriculture, manufacturing, and mining—were hurt by the strong dollar and weak world growth. Exports stagnated as U.S. goods were increasingly expensive on world markets, and our foreign customers often lacked the income to afford our exported products.

U.S. agricultural exports were especially hard-hit as the world already had large surpluses of many bulk commodities. In fiscal year 1998, farm exports dropped to $53.7 billion, down from $57.4 billion in fiscal 1997. Farm exports for fiscal 1999, which ended in September, are estimated to fall further to $49 billion. The declines are concentrated in bulk-goods exports, such as feed grains and oilseeds, while high-valued product exports appear to be largely unaffected.

Prices received by farmers reflected the weakness of bulk goods markets. The index of prices of all crops went from 127 in 1996 (index value 1990-92=100) to 116 in 1997, and fell further to 107 in 1998. But prices for food grains, which are largely exported, showed even more weakness, as the index fell from 157 in 1996 to 128 in 1997, and then declined sharply to 107 in 1998. In particular, wheat prices went from $4.30 per bushel in 1996 to $3.38 in 1997, and then dropped to $2.70 in 1998. Feed grains prices were also hard hit, dropping 46 percent over 2 years.

High-value farm product prices were relatively unaffected partly because of smaller export market shares of total production and continued high export demand. High-value farm products include both certain agricultural commodities, such as fruits and nuts, and processed agricultural products, such as cigarettes and snack foods. For example, prices received by farmers for fruits and nuts dropped slightly between 1996-98. Commercial vegetables, grown to be sold as fresh produce or to be processed, saw prices rise almost 10 percent between 1996-98. Prices for processed fruits and vegetables stayed essentially level over the crisis period.

Nonmetro Labor Market Bounces Back After Crisis

The crisis brought a decline in goods export growth in 1997 followed by a sharp drop in early 1998 (fig. 2). Nonmetro employment growth declined along with goods export growth. As goods exports rebounded in late 1998 and the global financial crisis ended, the shock to the nonmetro labor market subsided. Metro labor markets were largely unaffected. Since the metro labor force is about 80 percent of the U.S. labor force, national-level employment continued to grow and the unemployment rate declined to 4.1 percent in October 1999—a 30-year low.

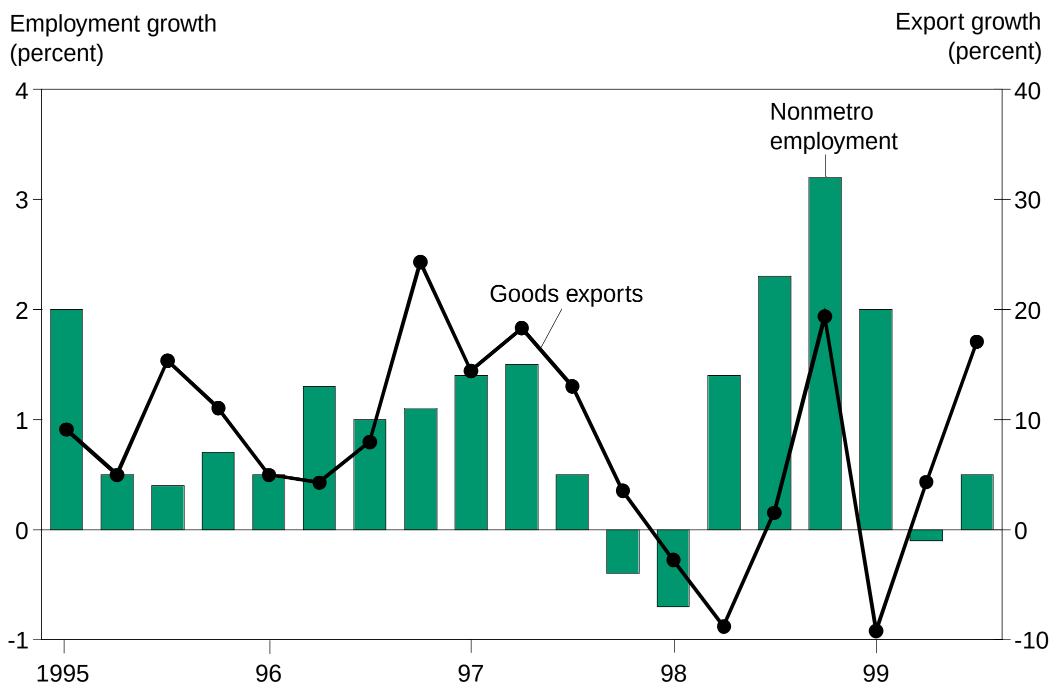
Food processing is one industry that mitigated the negative impact of the crisis on nonmetro areas. Employment in food processing is disproportionately rural, as 37 percent of the 1.8 million food processing workers live in nonmetro areas. The export category foods, feeds, and beverages, which has a high proportion of processed products, peaked in real dollar value in 1995 at $56.4 billion (1996 dollars) and dropped slightly to $55.5 billion in 1996. During the 1997-99 global financial crisis, exports of foods, feeds, and beverages stayed relatively high, with only modest declines, consistent with low impact that the crisis had on high-value agricultural exports.

At the start of the crisis, some analysts compared what was happening with the severe debt crisis of the 1980's. That debt crisis created lingering effects on the U.S. financial situation: high interest rates, a high-valued dollar, and continuing softness of the U.S. banking system. In particular, the very high-valued dollar made U.S. goods more expensive abroad. That debt crisis hit nonmetro areas disproportionately hard. Nonmetro unemployment did not recover to 1979 levels until 1989. In addition, farm real estate prices peaked in 1982 at $823 per acre, a price not again reached until 1995 when the average acre sold for $844. Although the 1997-99 global financial crisis did indeed result in a higher valued dollar, its rise was brief, small, and not associated with higher interest rates, which

Figure 2

Annualized growth rates of nonmetro employment and goods exports, 1995-99

Growth slowed during the 1997-99 global financial crisis



Note: Export growth adjusted for inflation, constant 1996 dollars.
Source: ERS analysis of U.S. Department of Commerce and Bureau of Labor Statistics data.

could have pushed the value of the dollar even higher. Consequently, the net impact on the rural economy was brief and shallow.

Prospects for Goods Sector Recovery in 2000

The U.S. economy is expected to slow in 2000 due to moderating consumer and business investment spending. The slower spending growth will be partly offset by a falling trade deficit, reflecting improvements of manufacturing export prospects.

Manufactured goods exports are expected to rise in 2000 due to improved world growth and a weaker dollar. Low inflation and interest rates, albeit somewhat higher than in 1998 and early 1999, and continued productivity growth will keep manufacturing profitable. *[Data as of 12/16/1999. David Torgerson, 202-694-5334, dtorg@ers.usda.gov; Karen S. Hamrick, 202-694-5426, khamrick@ers.usda.gov]*